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THE CITY OF EDINBURGH COUNCIL

Item no 8.3(a)
Report no CEC/38/09-10/CD&F

Edinburgh Tram Project – Status Report

The City of Edinburgh Council

20th August 2009

1 Purpose of report

1.1 The purpose of this report is to inform the Council about the progress of the Edinburgh Tram Project and provide updated information on a number of issues including: the budget and construction programme; the Council's funding strategy; and a review of the Transport Edinburgh Limited (TEL) Business Plan. The report also seeks Council approval for the **tie Ltd** Business Plan.

2 Summary

2.1 A report was provided to the Council meeting of 30 April about the work being undertaken by **tie Ltd,** through their commercial engagement with the Bilfinger Siemens CAF (BSC) consortium, to review the tram programme base costs, assess key risks and achieve a revised, commercially agreed programme. Since the last report to Council, there have been some changes to the risk profile for the project which present significant challenges to its delivery within the approved funding envelope. This report gives an initial view of the implications for the programme, key budget risks and contingency management arrangements.

2.2 Council officers have also commissioned an external review of the Council's £45m contribution to the tram project and the results of this are described in the report.

2.3 On 30 April, 2009 the Council asked for a review of the TEL Business Plan to assess the impact of the recession on future service viability. This report summarises the conclusions of that review.

2.4 The Council's operating agreement with **tie Ltd** requires the company to prepare an annual business plan setting out its planned activities. This report seeks Council approval for **tie Ltd's** 2009/10 plan.

3 Main report

Programme and Costs

3.1 The Tram report to Council on 30 April 2009 provided information about the review being carried out by **tie Ltd** and the BSC consortium to assess the tram programme and timetable with a view to achieving a revised, commercially agreed programme by the end of June 2009.

3.2 The report explained that **tie Ltd** had entered formal Dispute Resolution Procedures (DRP) on certain elements of the Infraco contract and explained the Project Management Panel (PMP) arrangements put in place to resolve constructively any points of commercial and operational disagreement between the parties.

3.3 This process aimed to achieve a revised commercial baseline for the tram programme and to provide greater certainty about the timetable and projected outturn costs for line 1a.

3.4 Mediation on the first DRP process was held on 29 May, 2009 and an acceptable solution was reached for the disputed estimates in question.

3.5 However, despite prolonged discussions at the most senior levels between **tie Ltd** and the BSC consortium a revised programme and commercial baseline has not been agreed. This is despite a subsequent, externally facilitated, mediation process.

3.6 As a result, **tie Ltd** sought and received the full approval of the Tram Project Board (TPB) to take a more formal contractual approach to resolve the outstanding commercial issues.

3.7 **tie Ltd** has now carried out an in-depth review of the potential impact of this approach on the tram programme and budget. The review has taken account of known areas of increased costs such as the need for additional commercial and legal support, increases in recharges from partners, extra traffic management costs and other related costs such as those associated with unexpected ground conditions.

Utility Service Diversions

3.8 Additional cost pressures of around £7m (approximately 12% of works value) have arisen on the utility diversion works. The overall programme is now more than 80% complete and has achieved a major upgrading of key utilities along the tram route that will help secure vital infrastructure for the future and ensure that the tram is not disrupted by future utilities maintenance work. The additional expenditure on utility works is the result of extension of preliminary works due to programme slippage. There are also additional costs associated with measured works to completion and contractual claims settlements. While the slippage to the programme is regrettable it should be acknowledged that it has been a very challenging project with unexpected ground conditions, including the discovery of a number of underground chambers and inaccurate data held by utility companies and the Council having a significant impact.

Tram Rolling Stock

3.9 Excellent progress is being made with the construction of the tram rolling stock by CAF the Spanish member of the BSC consortium with responsibility for the manufacture of the 27 trams that will make up Edinburgh's tram fleet. The first tram will be ready for delivery in April 2010 in line with the original contract programme and a total of seven trams are currently at various stages of production.

tie Ltd Project Management Costs

3.10 **tie Ltd** has taken steps to ensure that its own project management costs are mitigated as much as possible. However, due to the contractual engagement with the Infraco consortium **tie Ltd** have had to strengthen their commercial and legal team which has increased costs. **tie Ltd** and the Council will continue to look at ways to reduce the cost base.

Dispute Resolution Procedure

3.11 The lack of an agreed commercial programme, arising from difficulties with the BSC consortium, and the decision to apply formal contractual measures to resolve the outstanding issues will present potential further risks in relation to the attribution of additional costs and delay to implementation, now forecast at Spring 2012. **tie Ltd** has taken extensive legal and technical advice, including Counsel's opinion, and is confident of its position on the key matters in dispute. However, given the nature of the process and the complexity of certain issues, it is unreasonable to expect that all adjudication outcomes will be awarded in favour of **tie Ltd** and it will also be open to the BSC consortium to use the contract formally to pursue their objectives.

3.12 Given the above issues, it is now considered that it will be very difficult to deliver the full scope of Phase 1a within the available project envelope of £545m. Until the key issues are resolved through the contractual and legal process, it will not be possible to forecast accurately a revised budget outturn. Council officers and **tie Ltd** are preparing contingency plans and reviewing programme delivery options.

3.13 The contingency planning process will be informed by discussions with Transport Scotland and other stakeholders, the current review of the TEL Business Plan and revised expectations about developer contributions. The conclusions will be reported to TPB and the Council in due course.

3.14 Contingency options under consideration include the possibility of a controlled amount of prudential borrowing with debt repayments funded through TEL profits, potential leasing arrangements or the Council's revenue budget or through identification of future capital spending when considering the roll forward of the Council's capital programme. These options would be available to the Council in the event that funding beyond that generated from developers contributions is required.

3.15 It is clearly regrettable that a satisfactory conclusion to the disputed matters has not been reached through the commercial negotiation process and that **tie Ltd** has had to seek contractual redress.

3.16 The contract with the BSC consortium prescribes a timetable for resolution of contractual disputes and it is expected that the budget and programme implications will become much clearer by January 2010. The Council is reminded of the extremely sensitive nature of the current commercial discussions and the continued need to protect commercial confidentiality at this time. Regular briefings have been agreed with political group leaders by senior Council Officers to keep them updated on the progress of the project programme and finances.

3.17 The project is now at a well developed stage and significant costs have been incurred. It is essential that this investment is protected and the programme is supported through to successful completion. For this reason the formal mechanisms that exist in the contract are now being invoked.

Council Funding

3.18 On 21 December 2006 the Council received a report explaining the Council's funding strategy. The strategy was externally reviewed by DTZ to check that its assumptions were soundly based and a further report was given to the Council on 20 December 2007.

3.19 In light of the economic downturn, Council officers asked DTZ to undertake a further review to assess whether the Council's strategy for delivering its contribution to the tram project remains competent and achievable. The brief given to DTZ was to:

- review the assumptions underpinning the contributions identified by the Council;
- review the Council's proposed funding model;
- assess the risks associated with each of the identified funding streams;
- review the Council's approach for dealing with the various risks including risk management and reduction measures; and,
- reach conclusions about the Council's funding strategy and approach to risk.

3.20 As part of this exercise DTZ assessed the short-to-medium term financing requirements and impact on project cashflow. This highlighted that the Council will have some new challenges as a result of the current standstill in the property development market and falling land values.

3.21 The Council has therefore taken a prudent approach to financial planning to deal with a fallow period over the next few years. In the longer term, the DTZ review suggests there remains enough scope for future planning applications to meet the required tram funding contributions.

3.22 DTZ also reviewed the Council's financial model. The key assumptions made in the model cover the scale and timing of construction outflows, set against the scale and timing of inflows from developers' contributions, capital receipts from land sales, and the costs of borrowing to cover any short-term deficits.

3.23 DTZ have concluded that the Council's modelling remains robust but notes that, as with any development-related funding, there may be risks to individual developer contributions. Given the depressed development market it highlights it is likely that a phased approach will now be taken to the development of Leith Docks area and that this could impact on the timing and availability of funding.

3.24 To address these challenges the Council has begun to prepare for a lean period over the next few years by ring fencing £3.2m of developers' contributions and arranging the sale of a windfall site of £2m. Prudent assumptions have also been made about the collection of developers' contributions over the next four years.

3.25 Despite the recession interest in development in Edinburgh remains strong and the above steps should enable the project to progress through the recession with an expectation that a higher level of contributions will return from 2014 onwards.

3.26 DTZ therefore conclude that, despite the economic downturn, the Council will be able to meet its obligations to the tram project, by funding loan costs and interest payments during the economic downturn and repaying the capital once the level of developer contributions and capital receipts recovers. This situation will be kept under close review as the project proceeds.

TEL Business Plan

3.27 Following the Tram report to Council on 30 April 2009 a Council motion was presented which requested an updated TEL Business Plan.

3.28 A key part of the Final Business Case for the Tram was the creation of an integrated public transport company for the tram and bus network. This resulted in creation of TEL to oversee the integration of the tram with existing Lothian Buses operations.

3.29 Experience from other tram schemes highlights that integration with other modes of public transport, particularly bus, contributes greatly to operational success.

3.30 By setting up TEL, the Council has reinforced its commitment to first class public transport services in the city. Edinburgh's approach to the integration of the tram with other modes of public transport sets it apart from other UK cities and will enable the combined network to achieve more than the sum of its constituent parts. Demand forecasts indicate enhanced profit potential arising from an integrated network.

3.31 Following the Council meeting of 30 April, further work has been undertaken to review the TEL Business Plan and provide an updated view on:

- Lothian Buses 3 year plan to 2011 within the framework of the TEL financial model.
- Re-calibrated Bus costs, using current Lothian Bus forecasts.
- Patronage forecasts using the most recent available performance information.
- The consequences of the Open for revenue service date slipping to early 2012.
- More prudent assumptions about operating costs

3.32 Sensitivity analysis has also been undertaken to take into account flexibility in assumptions about inflation and yield and issues around the application of the concessionary travel scheme.

3.33 The Transport Scotland view has always been that it is reasonable to assume that concessions will apply.

3.34 The forecast operating costs have been reviewed with a prudent approach to key assumptions. Bus and tram costs have been updated based on contractual rates, indexed at 3%. Labour costs are assumed to grow at 1% above inflation, fuel costs at 6.5% above inflation and electricity costs at 6% above inflation. The financial forecast includes taxation on forecast profits calculated at the prevailing rate of corporation tax. The figures in the table below are calculated on the assumption of Retail Price Index (RPI) at 3% and Fares at RPI + 1.5%. The business case is dependant on important factors such as oil prices and the fares increase is not inconsistent with past Lothian Buses assumptions.

3.35 Patronage forecasts have been updated from the 2008 modelling outputs, which already factored in delayed development in North and West Edinburgh, through a reduction of 10% in the initial years of tram operations taking account of the economic downturn. This is further demonstrated by a 10% reduction in passenger numbers experienced by Lothian Buses on relevant routes since the model was last updated. The table below illustrates projected TEL patronage, revenues and profit levels for selected years.

Tram in service	Pre-tram		Post Tram - Phase 1a			
Tram service pattern	n/a	n/a	6/12	8/16	8/16	8/16
Year	2006	2010	2012	2016	2021	2031
Patronage (million)						
Bus	108.0	107.0	98.7	109.4	121.6	133.4
Tram	-	-	11.9	17.8	20.2	25.5
Total TEL Patronage	**108.0**	**107.0**	**110.6**	**127.3**	**141.8**	**158.9**
Bus Revenues (£million)						
Farebox	82.0	107.6	106.5	140.9	195.1	332.2
Other	6.0	6.9	7.3	8.4	9.7	12.9
Total Bus Revenues (a)	**88.0**	**114.5**	**113.8**	**149.3**	**204.8**	**345.1**
Tram Revenues (£million)						
Farebox	-	-	12.5	22.3	31.5	61.7
Other	-	-	0.7	0.9	1.1	1.4
Total Tram Revenues (b)	-	-	13.2	23.2	32.6	63.1
Total TEL Revenues (a + b)	**88.0**	**114.5**	**127.0**	**172.5**	**237.4**	**408.2**
Operating Costs (£million)						
Bus			107.3	133.7	186.0	339.3
Tram			17.3	22.1	32.0	52.4
TEL head office			2.0	1.7	2.1	2.9
Total TEL operating costs (c)			**126.6**	**157.5**	**220.1**	**394.6**
Pre-tax operating profit/loss (a + b) - c			**0.4**	**15.0**	**17.3**	**13.6**
Notional taxation			0.1	4.2	4.8	3.8
Dividend payment			-	2.6	3.0	4.1
Net TEL cash surplus/deficit			**0.3**	**8.2**	**9.5**	**5.7**

3.36 The results of the work on costs and patronage assumptions underpin the financial forecasts for TEL's future operations.

3.37 The conclusion of this work is that the operational cash flow profile will be positive once the tram and bus patronage has stabilised following an initial "ramp-up" period after revenue services have begun and that the ongoing integrated network will be able to operate without subsidy.

3.38 The table above shows that even during an initial period of tram patronage build up, the TEL business as a whole will be profitable and should experience significant growth in profits once the tram patronage is fully established.

tie Ltd Business Plan

3.39 The operating agreement between the Council and **tie Ltd** requires the company to supply the Council with an annual Business Plan setting out the company's activities, costs and funding for the year. This Business Plan requires approval by the Council.

3.40 **tie Ltd** has supplied its draft Business Plan for 2009/10 and this appears as a background paper to this report.

3.41 **tie Ltd's** activities are now almost exclusively focused on the delivery of the Tram project. The company's only other significant activities involve administration of the 'One-Ticket', multi operator travel ticket; their ongoing role as Authorised Undertaker in the winding up of the EARL rail project; their participation in European Commission funded research projects on road user charging issues and intelligent vehicles; and their involvement in steering group meetings exploring possible cross Forth ferry and hovercraft developments.

3.42 In their delivery of the Edinburgh Tram project over the course of 2009/10, **tie Ltd** will focus its efforts on:

- Continuing track installation works;
- The completion of all utilities diversion works;
- Lodging of the TRO documents required for the permanent tram operation;
- The completion of Design assurance;
- The completion of all drawings issued for construction (IFC);
- The completion of all consents and granting of approvals;
- Princes Street tramway construction complete;
- A8 Underpass Complete;
- The off-site testing of the first tram and assurance that tram rolling stock will be ready on time for delivery.

3.43 The ongoing engagement with the main tram construction consortium BSC to achieve a commercially agreed programme will impact upon the timing of a number of these milestones.

3.44 **tie Ltd** anticipate incurring a total of £153.3m in tram related expenditure in 2009/10 in addition to the cumulative spend on the project of £234m up to 31 March 2009.

3.45 Experience gained during the initial closure in October 2008 of the Mound to effect MUDFA works, resulted in the establishment of a new multi-stakeholder Traffic Management Review Group being chaired by the Tram Monitoring Officer (the Head of Transport). This approach helped achieve the successful implementation of the Princes Street traffic diversions, in early 2009, and this group will consider all remaining major temporary traffic management issues arising from the delivery of Tram.

4 Financial Implications

4.1 Given the legal process **tie Ltd** is entering into with the BSC consortium it is not possible to give a clear indication of the impact of these issues on the overall funding for the project. The outcome of the contractual resolution process will provide greater certainty on the final budget out-turn and will be reported to Council in due course. In the intervening period, the Council will continue to make contingency planning arrangements to identify scope for cost reductions and prepare for the possibility of additional funding requirements.

5 Environmental Impact

5.1 The Edinburgh Tram Project will make a positive contribution towards reduced vehicular emissions and air quality in the city centre and the transport corridor to the west of the city and the airport. This will have a positive impact on current pollution levels and provide a quieter mode of public transport.

6 Conclusions

6.1 Despite the efforts of **tie Ltd** through the PMP and informal mediation, there remain fundamental differences between **tie Ltd** and the BSC consortium on a number of issues which will affect the programme and costs for the project. **tie Ltd** are now invoking contractual resolution procedures. This process will take several months to resolve, the result of which will provide greater clarity about the ultimate programme timetable and costs.

6.2 There have been some additional costs to the project arising from the utility works. These result from the prolongation of the works, associated preliminary costs, measured works and contractor claims arising from unexpected ground conditions, including the discovery of a number of underground chambers, and inaccurate data held by utility companies and the Council.

6.3 Ongoing risks remain relating to the outcome of the contractual resolution process and less significantly in relation to the Council's funding position. The overall business case for the integrated service remains robust and in light of progress and expenditure to date the best strategic option at this stage is to see the contractual position through to a conclusion.

6.4 The external evaluation of the Council's funding strategy for the tram project concludes that despite some short term challenges the overall approach and requirement from developers contributions can be achieved in the long term. The financial modelling undertaken by the Council remains robust and takes a very prudent approach to the timing and quantum of developer contributions. The Council will continue to have its approach evaluated periodically until the wider economic outlook become clearer. This situation will be kept under close review as the project proceeds.

6.5 A further update of the TEL Business Plan has been completed including updates to patronage forecasts, taking account of the experiences of Lothian Buses over the last year. There has also been a prudent review of all cost and revenue projections. The Business Plan continues to provide a robust case for the tram as part of an integrated transport company that will deliver long term growth in profits and a first class public transport system for Edinburgh.

6.6 The Council requires to approve the **tie Ltd** Business Plan on an annual basis. The business plan indicates the company's activities are almost exclusively concentrated on the tram project and that engagement with the Infraco consortium will dominate their work over the year ahead. The Business Plan sets out the key milestones to be achieved in 2009/10 but is clear these will be affected by the legal process that is now underway.

7 Recommendations

7.1 It is recommended that the Council;

a) notes the updated position and endorses the contractual processes **tie Ltd** has entered into with the BSC consortium to produce greater cost and programme certainty.

b) approves the additional costs associated with the utility works subject to the necessary detail being provided to the Tram Monitoring Officer by **tie Ltd**.

c) notes the position on the external evaluation of the Council's funding strategy and the intention to undertake continual review of the position in light of wider economic uncertainty.

d) notes the updated position of the TEL Business Plan and the continuance of the robust case it puts forward for public transport in Edinburgh.

e) approves the **tie Ltd** Business Plan for 2009/10.

[redacted]

Dave Anderson
Director of City Development

[redacted]

Donald McGougan
Director of Finance
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Appendices	None
Contact/tel/Email	Alan Coyle 0131 [redacted] alan.coyle@edinburgh.gov.uk Andy Conway 0131 [redacted]ndy.conway@edinburgh.gov.uk
Wards affected	All
Single Outcome Agreement	
Background Papers	**tie Ltd** draft business plan for 2009/10